Central Securities Depository Regulation (CSDR) – regulation: Where are we standing?

Impact on (I)CSD client base and lessons to be learned for AECSD CSDs

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Will CSDR become a game changer in the European post-trading environment?
The following information is based on Clearstream’s own interpretations, and is provided to support Clearstream’s customers with their specific understanding of the CSD Regulation. This information does not constitute – nor is it intended to act as – any form of formal legal advice.
1. CSDR Overview

- EU Regulation on settlement and central securities depositories

- Regulation: EU 909/2014, Entry into force: 17 September 2014

- Applies to European Central Securities depositories (CSDs) and any entities being participants in those CSDs.

- Objective: to increase the safety and efficiency of securities settlement and the settlement infrastructures in the EU, to harmonise the different CSDs rules in Europe and to establish an enhanced level playing field among these CSDs

Enhanced operational efficiency and asset protection

More secure and competitive EU capital markets
## 2. CSDR Timeline

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<th>2016</th>
<th>2017</th>
<th>2018</th>
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<td>Jan</td>
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<td>✦ Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) enter into force and March 2017; CSDs have to apply for CSDR authorisation within 6 months</td>
<td>✦ Deadline to apply for the authorisation for the CSDs (end September 2017)</td>
<td>Entry into force of settlement discipline rules (May/June 2019)</td>
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<td>✦ Assumed publication of settlement discipline rules</td>
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<td>✦ National Competent Authorities declare &quot;completeness&quot; of application file one month following the deadline to apply for the authorisation for the CSDs (mid-November 2017)</td>
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<td>✦ Application preparation / Filing for authorisation</td>
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<td>✦ CSDs are authorised (mid-May 2018)</td>
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*Note: Timeline for settlement discipline rules is subject to change by Competent Authorities.*
3. Key impacts

**EU Member State CSDs**
- New operating licence
- Organisational requirements
- Prudential requirements

**CSD customers**

**New settlement discipline regime**
- T+2 settlement cycle
- Buy-ins
- Penalties

**Wider requirements**
- New account segregation rules
- Daily reconciliation processes
- Book entry form of securities
- Using of Legal Entity Identifier (LEI) codes

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3. Key impacts
3.1. New operating licence – introducing a European passport for CSDs

CSDs are to apply for a universal **CSD license to operate**

- The license sets out **performance and operational criteria** all CSDs must fulfil including **enhanced governance, price transparency** and more stringent prudential requirements
- CSD **customer on-boarding and risk management protocols** are also addressed to help enhance asset protection
- Clearstream CSDs are on target with reviewing their operations and internal procedures, and adjusting these, where required, to comply with CSDR.

What kind of licences Clearstream applies for?

**CBL**: CSD Licence, Banking Licence and an Interoperable Link Licence for the Bridge with Euroclear.

**CBF**: CSD Licence and Banking Licence

**LuxCSD**: CSD Licence

**CSD applications due end September 2017**
CSDR requirements with customer impact
Prudential Requirements

- Credit lines
- Custody advances
- Bank guarantees
  need to be collateralised

Collateral hierarchy & tiers
New rules for
  - Collateral valuation
  - Collateral haircuts

Debit interest at a minimum threshold

Comprehensive risk management framework covering
  - Legal risk
  - Operational risk
  - Investment risk
  - Overall business risk
CSDs will require customers to ensure settlement on the **intended settlement date**. Settlement efficiency will be monitored and reported to regulators: individual CSD customers’ performance will be reviewed by CSDs, sanctions for non-compliance may apply.

A new settlement discipline regime will introduce **cash penalties** and mandatory **buy-ins** when settlement fails.

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Final ESMA technical standards for "Settlement Discipline" are still pending, entry into force is expected mid-2019 (tbd)
3.2. CSDR Settlement Discipline Regime
Buy-ins and Penalties (2/3)

- **Penalties:** CSDs will calculate and report the amounts due on a daily basis; collection/redistribution will take place at least monthly.

- **Buy-in:** Trading parties, central counterparties (CCPs; for cleared business) will be required to initiate the buy-ins and report the outcome to the CSDs.

- **Buy-in:** Trading parties, central counterparties (CCPs; for cleared business) will be required to perform cash compensation in case the buy-in fails and report details to the CSDs.
3.2. CSDR Settlement Discipline Regime
Buy-ins and Penalties (3/3)

- Settlement status: A settlement instruction is matched, but fails due to lack of securities for three business days after the intended settlement date.

- Let us suppose that the reference price (in this example being the closing price of the shares on the most relevant market in terms of liquidity) to be applied for penalty calculation is as follows:
  - Day 1: EUR 100
  - Day 2: EUR 115
  - Day 3: EUR 90

- The penalty would therefore be calculated as follows:
  - Penalty day 1: 1,000 shares x 0.01% x 100 EUR = 10 EUR
  - Penalty day 2: 1,000 shares x 0.01% x 115 EUR = 11.50 EUR
  - Penalty day 3: 1,000 shares x 0.01% x 90 EUR = 9 EUR
  - Total penalty amount = 30.50 EUR.

- The total penalty amount would have to be paid by the customer that is failing to deliver the securities, to the customer suffering from the failure to receive securities. Such payments will be facilitated by the CSD.

Example scenario of the cash penalty rates in practice

- CSD = Clearstream Banking AG
- Securities = Internal delivery of 1,000 liquid shares against payment of EUR 100,000.
- The applicable daily penalty rate would in this example be 1.0 basis point
3.3. Wider customer impacts

- CSD customers to offer to their clients choice between
  - Omnibus client segregation
  - Individual client segregation

- CSDs and CSD customers to disclose
  - Levels of protection
  - Costs associated

- CSD customers to reconcile their records with the information received by the CSD on a daily basis

- The end of paper securities (dematerialisation or immobilisation)
  - Securities
    - transferable
    - admitted to trading or traded on trading venues
  - Compliance to be achieved as of
    - 2023 for new issues
    - 2025 for everything else

- LEI (Legal Entity Identifier) - unique 20 character code that identifies legal entity
  - CSDs to collect LEIs from
    - CSD customers,
    - issuers
  - CSDs to record and report LEIs to their NCAs
CSDR – Game Changer in the European Post-Trade Landscape

**CSDR benefits**
- Systemically important securities infrastructures are subject to common EU rules
- CSDR addresses the costly fragmentation of securities settlement market infrastructure
- CSDR stimulates competition between CSDs

**CSDR challenges**
- Represents a big structural change in market practices
- Significant technical changes for CSDs to make the necessary adaptations
- Capacity for domestic CSDs to innovate in an environment of a change
- National protectionism

**Relevance to AECSD CSDs**
- Are you client/participant of CSDR impacted (I)CSD?
- Do I need to review my set-up?
- Do I advise my clients?
- What elements can be applied in my market?
- Can I apply CSDR principles to cross-border securities settlements in my region?